slightly modified version of Method III,[269] while Pacific concedes that Method III assigns the full value of the exogenous costs to the proper category.[270]

e. Oppositions

154. AT&T states that Method I has the advantage of producing only minor changes in the pricing of upper and lower limits of the service categories in existence prior to the restructure and is generally consistent with price cap policies. AT&T believes the disadvantages are that Method I is the most complex and difficult to understand of the three methods.[271] MCI states that Method I results in changes to the SBIs for the existing service categories within the traffic-sensitive basket and is therefore a violation of price cap rules.[272] AT&T states that Method I appears to require a waiver of the price cap rules because there is no downward SBI adjustment at the time of the restructure to reflect reductions in the rates for the original categories.

155. AT&T believes that Method II violates the price cap principle that costs be assigned to the cost causer because this method has a tendency to spread data base costs, thereby raising SBI limits for other service categories within the traffic-sensitive basket. According to AT&T, although technically in compliance with the price cap rules, this method is not in the public interest because it raises upper and lower SBI limits for all categories in the traffic-sensitive basket, thus producing unwarranted additional pricing flexibility in the other service categories.[273] AT&T asserts that the Commission should require companies that use Method II to revise their filings to use Method III, reasoning that failure to require compliance with price cap policies now will result in permanent unintended pricing flexibility in other service categories within the traffic-sensitive basket in the future. MCI states that LECs might take advantage of the additional pricing flexibility gained as a result of using Method II to raise rates in some service categories, particularly where a service category has only a few rate elements.[274]

156. AT&T suggests that if the Commission determines that LECs, by using Method II, violated price cap rules and policies in restructuring their traffic-sensitive baskets,

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[269] GTE would modify Method III by including overhead costs and by not adjusting the API. GTE Direct Case at 6.

[270] Pacific Direct Case at 8.

[271] AT&T Opposition at 7-8.

[272] MCI Opposition at 41.

[273] AT&T Opposition at 8-9.

[274] MCI Opposition at 40-41.

it should require those LECs to refile using Method III.[275] AT&T and MCI support the use of Method III. To maintain the level of the existing SBIs, MCI urges the Commission to grant a blanket waiver of the price cap rules so that it can require LECs to use Method III.[2]

f. Replies

157. BellSouth states that although it gained some pricing flexibility as a result of its Method I calculations, it did not raise rates for services in the traffic-sensitive basket prior to its 1993 annual access tariff filing. Therefore, it states that it did not gain any additional pricing flexibility as a result of using this method.[277] United disputes MCI's assertion that Method I violates the price cap rules. United claims its application of Method I did not have an impact on either existing rate levels for traffic-sensitive services or pricing flexibility for those services because the exogenous cost changes associated with 800 data base service produced only minor changes to the SBIs.[278]

158. US West defends its use of Method II, stating that calculations for this method are relatively simple. US West believes that Method II is the only method that complies with the Commission's Rules.[279] Southwestern explains that any change in pricing flexibility associated with Method II is caused by the exogenous cost change, not the restructure -- which is revenue neutral. Southwestern points out that the existing rules require a change in all service category band limits when a basket PCI is modified as a result of an exogenous cost change. It argues that there is no reason to treat the exogenous change for 800 data base service differently from the general rule. Southwestern further states that while some rate flexibility was gained as a result of its Method II calculations, it did not adjust any of its rates prior to the 1993 annual access filing. Southwestern refutes AT&T's assertions that LECs will gain permanent pricing flexibility by using Method II, arguing that unused pricing flexibility is lost at the end of each annual access tariff period.[280] Bell Atlantic believes that Method II is flawed because it does not address restructuring of 800 NXX rates or any other rate that ceases to exist after the restructure.[281]

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[275] AT&T Opposition at 10.

[276] MCI Comments at 41.

[277] BellSouth Reply at 7-8.

[278] United Reply at 2-3.

[279] US West Reply at 20.

[280] Southwestern Reply at 12.

[281] Bell Atlantic Reply at 4.

LEC files rates that cause the SBI to fall below the lower limits, this triggers close scrutiny of the proposed rates by the Commission. In this case, the upper and lower limits were raised as a result of an exogenous cost adjustment, not a change in prices by the LECs. Since this is an unintended result of applying the price cap rules and not the result of predatory pricing, the Commission will not require that LECs either increase rates to bring the SBIs above the lower limits or make a below band cost showing to justify leaving rates where they are. If LECs had used this "headroom" to raise rates, they would, as AT&T suggests, have gained some permanent additional pricing flexibility, because their SBIs would reflect the increased revenues at the end of the tariff year. At the beginning of the next tariff year, the LECs would reset their upper and lower limits at 5 percent above and 10 percent below the SBI. Thus, the increases in the SBIs would become permanently embedded. After the annual filing, the LECs could have raised rates an additional 5 percent above their new SBI. None of the LECs that used Method II, however, raised rates in the traffic-sensitive basket prior to their July 2, 1993 annual access filings. Since the PCIs, SBIs and the SBI upper and lower limits were reset at the time of the 1993 annual access filing, these LECs lost any extra headroom they may have gained by using Method II when their 1993 access rates took effect.

163. We disagree with Southwestern that the PCI, API and SBI adjustments due to the exogenous cost change for 800 data base service should be treated the same as PCI, API or SBI adjustments due to any other exogenous cost change. The circumstances here are unique because the increase in the traffic-sensitive basket's PCI as a result of exogenous costs has occurred simultaneously with the introduction of a new service category within the basket and a restructure of the basket. Therefore, we believe we need to evaluate the specific facts of this case to ensure that the purposes of the price cap rules are furthered by the methods the price cap LECs have selected to implement the 800 data base service restructure, and that the resulting rates and SBIs are reasonable.

164. On the basis of the foregoing discussion, we conclude that LECs that used Method I achieved reasonable results that conform to price cap principles, while LECs that used Method II complied with the price cap rules. In our view, each method has some merit. We find no reason to prescribe either method of restructuring traffic-sensitive baskets and adjusting for exogenous cost charges. Because Method I does not comply with our rules, however, we grant on our own motion a waiver of Section 61.47(a) of the rules for the limited purpose of allowing LECs to use this method. In *WAIT Radio v. FCC,* 418 F.2d 1153 (D.C. Cir. 1969), the court held that a waiver of the rules is appropriate only if special circumstances warrant a deviation from the general rule and such deviation will serve the public interest. The court further stated that an agency must explain why deviation better serves the public interest and articulate the nature of the special circumstances to prevent discriminatory application and to put future parties on notice as to its operation. *Id.* at 1156. In *Northeast Cellular v. FCC,* 897 F.2d 1164 (D.C. Cir. 1990), the court stated that one of the requirements for a waiver was for the agency to articulate a standard by which the court could determine the policy underlying the agency's waiver. Because LECs reach the same end result whether they use Method I or Method II, the public would not benefit if we

159. Most LECs oppose AT&T's suggestion that LECs be required to use Method III. The LECs argue that Method III violates Section 61.47(e)(1) of the Rules because the SBI upper and lower limits would not be adjusted to reflect the change in the PCI.[282] Bell Atlantic states that Method III freezes SBI limits and isolates 800 data base exogenous costs to the 800 service category, a result not contemplated by the price cap rules. Bell Atlantic suggests that the same effect could have been achieved by treating 800 data base as a new service, which the Commission specifically refused to do.[283] GTE believes the Commission should allow LECs to use Method III, but should not mandate any specific approach that could set a precedent that would govern future filings.[284]

g. Discussion

160. The Commission's rules do not explicitly address the proper sequence for modifying a PCI and service categories when both the exogenous adjustment rules and the restructure rules are triggered simultaneously by the creation of a new service within a basket. As described above, the LECs have demonstrated that the effect of complying with the requirements of the price cap rules varies depending on the order in which the carrier performs the operations. In the discussion below, we evaluate the two methods used by the LECs to determine whether those methods comply with the rules, and whether either method has an adverse effect on rate levels or rate flexibility.

161. The LECs that used Method I -- performing the restructure first -- appear to have achieved a result that more closely conforms with the principles of price cap regulation. Under this method, costs are borne by the cost causer and there is no change in pricing flexibility for the service categories in a basket that existed prior to the restructure. Method I does not, however, strictly comply with the price cap rules because the SBIs are not adjusted when the existing rates are adjusted for the exogenous cost changes.

162. US West is correct in its assertion that Method II is the only method that completely conforms to the price cap rules because it adjusted its PCI and SBI upper and lower limits in tandem with the PCI change for the basket. LECs that used this method gained some "headroom" in existing service categories because the upper and lower SBI limits were raised without raising the SBI. In fact, using this methodology, because some SBIs were not raised, they were below the lower band limit after the SBI limits were raised in tandem with the PCI increase for the basket. The Commission established the lower SBI limits as a safeguard against potentially predatory prices. The purpose, therefore, of establishing lower limits is to alert the Commission to possible predatory pricing. When a

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[282] Ameritech Reply at 2; Bell Atlantic Reply at 3; SNET Reply at 4-5; NYNEX Reply at 4; Southwestern Reply at 12; US West Reply at 21.

[283] Bell Atlantic Reply at 4.

[284] GTE Reply at 14.

required LECs that used Method I to refile their cost support using Method II. Such a refiling, however, would place burdens on the LECs without any benefit to the public.

165. Finally, we agree with the LECs that Method III violates the price cap rules because the SBI upper and lower limits would not be adjusted in tandem with the change in the PCI. We need not decide in this Order, however, whether LECs should be granted a rule waiver to use Method III because no LEC chose this method to restructure its traffic-sensitive basket to include the 800 data base service category and to calculate the exogenous costs for 800 data base service.

3. Reasonableness of the Price Cap LECs' Use of Demand to Demonstrate Compliance with the Price Cap Restructure Rules

a. Description of the Issue

166. Levelized demand is a term of art in ratemaking that merely means "average demand over a several year period." Levelized demand is usually used together with levelized, or average, costs for the same period, in order to calculate rates that will be accurate over the period. Rates calculated in this manner are set equal to levelized cost divided by levelized demand. The actual averaging methods are usually more complicated than simple averaging of annual amounts. Typically, the averaging methods use a "present discounted value" approach that applies discount factors to the multi-year stream of demand or cost, in order to determine a single base-year demand amount and a single base-year cost amount.

167. This section of the Order analyzes whether LECs have used reasonable estimates of demand to demonstrate compliance with the price cap restructure rules. We focus on the reasonableness of some LECs' use of a one-year period for calculating exogenous costs. We also focus on whether it is reasonable for BellSouth, Pacific, Southwestern and US West to have used a one-year base period for determining"non-levelized" demand for this showing.

b. LEC Pleadings

168. Although LECS have used several methods for calculating 800 data base query demand, most used some form of "levelized" demand. Most LECs calculated levelized demand by applying a discount factor to annual estimated demand occurring over five years. Ameritech, Bell Atlantic, NYNEX, United and GTE use levelized demand as a component of their rates.[285] These LECs develop rates by dividing their claimed five-year levelized 800 data base exogenous costs by their estimated five-year levelized 800 data base queries. Bell

[285] Bell Atlantic Direct Case at 5; Bell Atlantic Reply at 8; NYNEX Direct Case at 11; GTE Reply at 13; United Reply at 4.

Atlantic and NYNEX defend their use of levelized demand by arguing that rates would be greater if demand projections for the 1991 base period or for the first year of the service were used because demand during those periods will be lower than in subsequent years and thus result in higher rates. According to NYNEX, the result would be that the claimed exogenous costs would need to be divided by a smaller demand figure, resulting in a higher per-unit cost figure than if it used levelized demand.[286]

169. On the other hand, BellSouth, Southwestern, Pacific and US West used demand for a one-year period to calculate their rates. Southwestern argues that, under price caps, LECs are required to use 1991 base-period demand and that dividing exogenous costs by demand from a period other than 1991, the base period, is inconsistent with the price cap rules.[287]

c. Oppositions

170. AT&T and Ad Hoc are concerned that the use of levelized demand under price caps will result in over-recovery of exogenous costs over time.[288] AT&T argues that the use of levelized demand for exogenous cost calculations is inappropriate and will allow LECs over time to recover more revenue than is required to offset exogenous costs.[289] This occurs, AT&T contends, because the levelization process normally assumes that LECs receive an equal level of revenue each year, whereas an exogenous adjustment applied under price caps, assuming demand is increasing, generates revenue that exceeds the amounts required to cover exogenous costs.[290]

171. MCI, Sprint and First Financial are concerned that the growth in demand estimates used by the LECs in determining exogenous costs varies considerably among LECs and, for some LECs, might be too low.[291] MCI believes that low demand estimates among LECs are illogical because demand for 800 service should be stimulated uniformly throughout the LECs' territories. According to MCI, it has experienced a nationwide

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[286] NYNEX Reply at 7.

[287] Southwestern Reply at 8.

[288] Ad Hoc Opposition at 12.

[289] AT&T Oppostion at 16.

[290] *Id.* at 16-17.

[291] Compuserve Opposition at 9; First Financial Opposition at 8; Sprint Opposition at 14-

increase in new customers and would expect the same growth experience to affect all LECs relatively uniformly throughout the country.[292]

172. Sprint argues that Pacific and Southwestern incorrectly calculated rates because the LECs used costs from one period (1991-1995) and divided them by base-period demand (1991) which represents a different time period.[293] Sprint believes this method is inappropriate for exogenous cost calculations because higher total implementation costs are divided by demand figures that fail to account for demand growth. Sprint argues that this cost and demand mismatch will result in higher per-query rates than levelization, which does account for demand growth.

d. Discussion

173. The methodology that the LECs used to determine their demand and calculate their exogenous costs falls into three basic categories. First, many LECs use a five-year period to average or levelize both their demand and their exogenous costs. A second group of LECs use a one-year period to estimate their demand, while using a five-year period to levelize their exogenous costs. A third category of LECs use a one-year period both to estimate their demand and calculate their exogenous costs. Under our restructure rules, LECs are not required to set 800 data base rates to recover exactly their exogenous costs. Rather, the sum total of all rates in the traffic-sensitive basket, including 800 data base rates, must recover revenue that is no greater than that permitted in the base year, plus exogenous costs. Thus, for example, LECs are free to raise 800 data base rates as long as other traffic-sensitive rates are lowered equivalently. Similarly, if LECs have been pricing below cap in the traffic-sensitive basket, LECs could raise 800 data base rates above the level required to recover exogenous costs.

174. Two time periods are at issue here -- the length of time used to determine exogenous costs for the purpose of adjusting the PCI and the length of time used to determine demand for the purpose of calculating rates. First, exogenous costs must be calculated in accordance with the methodology specified in Section 61.45(c) of the Commission's Rules.[294] That Section is silent as to the length of the period over which an exogenous adjustment must be spread. We find that it is unreasonable to calculate exogenous costs in this instance on less than a five-year levelized basis. This is a start-up period for 800 data base service and it is to be expected that the LECs will incur higher exogenous costs during the early years of the service. It would not be appropriate, therefore, to base a permanent exogenous adjustment on a shorter time period during which the LECs might be expected to incur costs that are not representative of their long-run costs. We therefore

[292] MCI Opposition at 44.

[293] Sprint Opposition at 12.

[294] 47 C.F.R. § 61.45(c).

direct LECs that, in their ratemaking calculations, based their exogenous costs on a one-year base period to revise their exogenous costs to reflect levelization over five years. This is consistent with the Commission's past practice; because some exogenous adjustments result in a significant permanent change to a LEC's PCI, the Commission has sometimes required the total exogenous adjustment to be spread over a multi-year period.[295] In this instance, it is more reasonable for LECs to levelize exogenous costs over a five-year period than to use a one-year period. Therefore, US West and Pacific must amend their filings to use five-year levelized costs.

175. The second issue is whether LECs should use a one-year or five-year period to determine demand. BellSouth, Southwestern, Pacific and US West each used a one-year period to determine demand; the other price cap LECs used a five-year period. It is true that Section 61.3(e) of the Commission's Rules[296] specifies a one-year base period to determine demand. The LECs that used a five-year period to calculate demand, however, calculate a lower rate than they could justify if demand were calculated on a one-year basis.[297] From a policy perspective, LECs that used five years of levelized demand to calculate their rates in the restructure appear to have chosen the more reasonable method.

176. We now consider whether a waiver of Section 61.3 of the Commission's rules is appropriate in this instance. As previously discussed, a waiver of the rules is appropriate only if special circumstances warrant a deviation from the general rule and such deviation will serve the public interest.[298] In the present case, the levelized demand method adjusts lower initial demand with expected increases in annual demand. The five-year period for calculating demand more accurately recovers the LEC's exogenous costs for the service. We find, therefore, that a waiver of Section 61.3(e) of the Commission's Rules is in the public interest and is justified. Thus, those LECs that used a five-year base period for calculating levelized demand are hereby granted a waiver of Section 61.3(e) to allow them to use a five-year base period in this instance. However, the use of a one-year base period for the

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[295] Uniform Accounting for Post-Retirement Benefits Other Than Pensions in Part 32, 7 FCC Rcd 2872 (Com. Car. Bur., 1992) (RAO Letter 20) (The Accounting and Audits Division of the Common Carrier Bureau ordered the obligations to be deferred over a 20-year period or over the average remaining service period of active plan participants, as permitted by Statement of Financial Accounting Standards, No. 106).

[296] 47 C.F.R. § 61.3(e).

[297] This occurs because rates are calculated by dividing cost by demand. Rate calculations that include five years of estimated demand include demand growth. Demand estimates for a five-year period, therefore, are higher than base-period demand when demand for a service is increasing. The result of dividing costs by higher demand is lower rates.

[298] *See* ¶ 168, *supra*.

determination of demand is consistent with the Commission's rules and we will not prohibit it.

177. AT&T's argument that use of levelized demand will result in over-recovery of exogenous costs is incorrect. The impact of future growth in demand is included in levelized demand, which in this way offsets the impact of the demand adjustments that LECs are allowed to make under price caps.

178. Finally, with respect to the commenters' allegations concerning the LECs' estimate of demand growth, we conclude the commenters have not demonstrated that the LECs' demand estimates are unreasonably low or that they underestimate future growth.

4. Reasonableness of Price Cap LECs' Ratemaking Methodologies To Develop Vertical Features Rates

a. Statement of the Issue

179. The petitioners questioned the adequacy of the cost support for some of the LEC vertical features rates, such as demand figures, depreciation and tax expense. The LECs argued that their cost allocation factors used to apportion costs to and among vertical features are proper, even when they result in a zero incremental rate for a particular vertical feature. The Commission asked for comment on whether vertical features require the LECs to use more complex, and thus more costly, hardware or software functions than those used for basic queries. The Commission also asked whether those differences have any rate implications. Therefore, the *Designation Order* designated the issue of whether vertical features rates are reasonable.

b. Background

180. The Commission only requires a basic form of "area of service routing" to be included in the basic query service.[299] All other enhanced routing capabilities provided by the LECs are offered as vertical features. Vertical features are defined as any capability that is offered to purchasers of 800 data base access service but not included in the basic query service.[300] These include: (1) call validation (ensures that calls originate from subscribed service areas); (2) POTS translation of 800 numbers (converts the 800 number into a plain old telephone service 10 digit number); (3) alternate POTS translation (allows subscribers to vary the routing of 800 calls based on factors such as time of day or place of origination of the 800 calls); and (4) multiple carrier routing (allows subscribers to route 800 calls to different carriers based on factors similar to those stated above, such as time of day, or

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[299] *Comptel Petition Order*, 8 FCC Rcd at 1425.

[300] *See Provision of Access for 800 Service*, 4 FCC Rcd at 2825.

geographic location of the originating 800 call). The capabilities offered by vertical features can be used by an 800 customer to handle more efficiently peak traffic or use its workforce more efficiently.[301]

181. In the *800 Reconsideration and Second Supplemental NPRM*,[302] the Commission required that LECs unbundle vertical features from basic service to ensure that only those customers that actually use the services are required to pay for it. Further, in the *800 Rate Structure Order,* the Commission decided that because no LECs made a convincing showing that incremental costs for vertical features were inconsequential, there was no basis for allowing LECs to bundle one or more vertical features with 800 data base service.

182. The *800 Rate Structure Order* also required that the LECs provide these unbundled vertical services as "new" services under price caps,[303] which requires that they be accompanied by the cost support required for new services outlined in the *Part 69 ONA Order*. A LEC introducing a new service is required to submit its engineering studies, time and wage studies, or other cost accounting studies to identify the direct costs of providing the new service. Once the direct costs have been identified, the LEC can add overhead costs to derive the overall price of the new service. The cost support also must include the following information: (1) a study containing a projection of costs for a representative 12-month period; (2) estimates of the effect of the new service on traffic and revenues, including the traffic and revenues of other services; and (3) supporting workpapers for estimates of costs, traffic and revenues.[304]

c. Direct Cases

183. In supporting their vertical features rates, most LECs originally used confidential cost models, such as CCSCIS, to estimate unit investment, which is the basis for calculating vertical features rates. After the Bureau required the LECs to disclose these

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[301] For example, alternate POTS translation could allow an airline to shift its 800 traffic between its reservations centers by time of day. Calls to its 800 number could be routed to its east coast reservations center in the morning hours, shared between the east and west coast centers during the day and shifted to the west coast reservations center in the evening.

[302] *800 Reconsideration and Second Supplemental NPRM*, 6 FCC Rcd at 5428-29.

[303] *See Rate Structure Order*, 8 FCC Rcd at 911.

[304] *See* Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4531 (1991) (*Part 69 ONA Order)*.

proprietary cost models on the record, or use different cost support methodologies,[305] they filed supplemental cost support for their vertical features based on actual direct costs and overheads.

184. The LECs generally developed their cost support by determining the annual costs associated with vertical features based on the incremental difference between providing a basic service query and a basic service query that includes vertical features. The LECs generally included investment-related costs associated with SS7 components and included costs related to regional data bases, transfer point ports and signalling links. Non-investment costs generally include costs for right-to-use fees for software for local and regional transfer points, additional software in end offices, regional data base lease payments, circuit lease expenses for circuits between the regional data base and the central data base, and charges from DSMI for connection to the central data base.

d. Oppositions

185. MCI is concerned that LECs proposing no charges for vertical features are actually recovering the vertical features costs through basic query rates. It believes that as a result, larger IXCs, such as MCI, that have large data bases of their own that substantially reduce their need for LEC-provided vertical features, will subsidize smaller IXCs that must purchase LEC vertical features. MCI and First Financial argue that several LECs have bundled vertical feature rates for POTS translation. MCI recites language from the CC Docket No. 86-10 *800 Reconsideration and Second Supplemental NPRM*,[306] which reaffirms that LECs may bundle these rates only if they make a convincing showing that incremental costs for vertical features are so inconsequential that IXCs are not, in effect, required to pay for LEC services that they themselves provide.[307] MCI states that Ameritech and Southwestern have separate rate elements for POTS translations, but with rates set at zero. MCI argues that BellSouth proposes identical rates for basic service and for basic service with POTS translations. MCI argues that GTE bundles rates because it has two rate elements for 800 data base service, a rate element for a basic query and a rate element for a basic query with vertical features including POTS translation, both set at the same rate. MCI argues that since some LECs have shown that there are significant costs associated with providing vertical features and that no LEC has shown that these costs are inconsequential, all LECs should be required to charge rates for vertical services.[308]

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[305] *800 Cost Disclosure Order*, 9 FCC Rcd at 715.

[306] *800 Reconsideration Order and Second Supplemental NPRM*, 6 FCC Rcd at 5430.

[307] As discussed above at note 11, some of the larger IXCs provide their own vertical features through their own data bases and networks.

[308] MCI Comments at 56-57.

186. First Financial states that some of the LECs concede that they have allocated to their vertical features only the incremental costs of providing those features, thereby including all fixed costs in the 800 data base basic service rate.[309] Allnet argues that the LECs initially projected much higher demand for vertical features than they have actually experienced. For example, Allnet states that Bell Atlantic predicted that 30 percent of its 800 data base service basic queries would be associated with vertical features and now shows actual vertical feature demand of only 0.34 percent of all basic queries. Likewise, Southwestern predicted that 15 percent of its 800 data base basic queries would be associated with vertical features and now shows actual vertical features for only 5 percent of its queries. Allnet believes that, by overstating demand for vertical features, the LECs understated demand for 800 data base basic query service and thereby inflated basic query service costs.[310] Finally, MCI complains that BellSouth made no attempt to describe its methods of determining costs for vertical features.[311]

e. Replies

187. GTE argues that it did not bundle its vertical features and 800 data base basic query rates; rather, it calculated the rates separately and tariffed two distinct rate elements for basic queries and vertical features.[312] Southwestern and BellSouth defend setting their rates for the POTS translation vertical feature at zero on the basis that they cannot identify any incremental costs resulting from providing this feature. Each maintains that after it launches a query, the regional data base returns the query to the service origination point from which it was launched with the designation of which IXC will complete the call. The returned query can either include the 10-digit 800 number, for IXCs with their own data bases, or it can include a 10-digit POTS number for IXCs that must rely on the LECs' data bases.[313] According to these carriers, it costs no more to return a POTS number translated from an 800 number than to return the 800 number itself. BellSouth claims that the level of cost detail provided in its supplemental filing is more than adequate to establish that rates for vertical features are reasonable.[314]

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[309] First Financial Opposition at 6.

[310] Allnet Opposition at 7-8.

[311] MCI Comments at 22 n.64.

[312] GTE Reply at 17.

[313] Southwestern Reply at 16; BellSouth Reply at Exhibit 1, p.8.

[314] BellSouth Reply at Exhibit 1, p.7.

f. Discussion

188. In the *800 Reconsideration Order and Second Supplemental NPRM*, the Commission rejected requests to permit LECs to bundle specific vertical features with basic 800 query service.[315] In the Order, the Commission found that LECs had not proven that vertical features lacked significant discrete costs with sufficient specificity.[316] In the *800 Restructure Order*, it required the LECs to unbundle vertical features unless they could show that providing the vertical features did not entail significant costs.[317] Because MCI purchases basic query service and does not purchase vertical features, it believes it will, in effect, subsidize smaller IXCs that rely on vertical features provided by the LECs.

189. All of the LECs offer both basic 800 data base service and vertical features separately. The LECs, therefore, do not bundle basic and vertical services rates. Some of the petitioners, however, argue that basic and vertical services are effectively bundled because some vertical features are free. These petitioners contend that the costs of providing these vertical features are recovered in basic query rates.

190. In particular, MCI argues that some LECs have shown there are "significant costs" associated with the POTS translation vertical features, but impose no separate charge for this feature. The record does not support MCI's claim that some LECs have shown "significant costs" associated with POTS translations. Ameritech, Bell Atlantic, BellSouth, Pacific, Southwestern and GTE do not charge for POTS translations. NYNEX and United, on the other hand, have separate rates for POTS translations. NYNEX, however, states that it could not differentiate between the costs for POTS translations and the Call Handling and Destination vertical features. United does not show significant costs for either POTS translations or the Call Handling and Destination feature and charges for only one feature. A customer with the Call Handling and Destination feature, therefore, would pay nothing extra for POTS translation service. Although US West has a significant rate for POTS translations, it fails to show any costs associated with providing this vertical feature. The LECs that charge zero rates for the POTS translation feature make convincing arguments that they incur no additional costs in providing that vertical feature and, therefore, that it is not unreasonable to set the rate for this feature at zero. Moreover, because of the low level of costs shown in the LECs' cost support for vertical features and the extremely low demand for these features that the LECs have actually experienced, we find that MCI's arguments about the cross-subsidization of vertical features by basic query service are unfounded.

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[315] *800 Reconsideration Order and Second Supplemental NPRM*, 6 FCC Rcd at 5430.

[316] *Id.*

[317] *Rate Structure Order,* 8 FCC Rcd at 908.

191. Under the price cap rules, vertical features offerings are treated as new services for which the LECs must demonstrate that the price recovers the direct costs of the service.[318] A LEC may also show that it recovers a reasonable level of overheads if it so chooses. We find that, with the exception of Ameritech and US West, the data provided by the LECs to support their vertical features rates comply with the Commission's cost support requirements for new services. No party has contradicted this finding or provided a convincing argument that these rates are unlawful or unreasonable. We therefore will allow these vertical feature rates to take effect as filed.

192. US West uses the following methodology to determine vertical features costs: (1) it estimates the demand for vertical features as a percent of total 800 data base queries (0.2 percent); (2) based on this percentage, it allocates 0.2 percent of 800 data base exogenous costs, or $17,760, to vertical services;[319] (3) based on its relative use of vertical features estimates, it allocates 5 percent, or $888, to the POTS Translations feature, and 95 percent, or $16,872, to the Call Handling and Destination feature; and (4) it determines unit costs by dividing the exogenous costs for each feature by the estimated demand for each feature.

193. US West fails to provide cost support required under the new services test for its POTS translation and Call Handling and Destination vertical features. Specifically, US West fails to provide the economic costs required by Section 61.49(h) of the Commission's Rules.[320] US West's costing methodology cannot justify additional charges for vertical features because the exogenous costs it identifies are already recovered through US West's 800 data base basic query rates. US West fails to provide any investment amounts for the regional data base, transfer points, or data links.

194. For the reasons discussed earlier at paragraphs 87 through 90, Ameritech also fails to provide cost support for its vertical features that the new services test requires. Specifically, Ameritech fails to show the procedures it used to determine its vertical services costs or to show any supporting workpapers. In addition, Ameritech provides none of the calculations it states that it performed, or any of the data used in those calculations. Also lacking in Ameritech's cost support are any investment amounts for the regional data base, transfer points or data links.

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[318] *Rate Structure Order,* 8 FCC Rcd at 911. *See also* Section 61.38(b)(2) of the Commission's Rules, 61.38(b)(2).

[319] US West reduced the amount of exogenous costs used to develop its vertical features rates from $8,879,879 to $4,326,788. US West Reply at 19. US West, however, did not revise its vertical features rates to reflect this reduction.

[320] 47 C.F.R. § 61.49(h).

195. Without adequate support, we cannot accept the vertical features costs that Ameritech and US West claim. We believe, however, that these LECs likely have incurred some costs for vertical features and that these costs are commensurate with those claimed by the other BOCs. For this reason, and in the absence of any other reliable information from Ameritech or US West, we will not allow Ameritech or US West to impose any rates for vertical features that exceed the average rates for the vertical features that we allow the BOCs to charge in this Order. We are not including the costs of United, GTE or SNET in calculating this average because United and GTE each serve widely dispersed areas and have categories of costs, specifically right-to-use fees, that the BOCs do not incur. We exclude SNET because its smaller size and lower costs do not provide for accurate comparisons with Ameritech and US West. The rates proposed by Ameritech fall below this average and are therefore considered reasonable. Likewise, the rate for call handling and destination for US West falls below this average and is therefore considered reasonable. US West must revise its rate for the POTS translation feature to an amount not to exceed $0.0006932, which is the average of the rates charged by the other BOCs for that vertical feature.

C. 800 DATA BASE ACCESS TARIFFS FOR RATE-OF-RETURN CARRIERS

1. Tariffing When Originating LEC Does Not Have a Service Origination Point (SSP)

a. Description of Issue

196. The *Designation Order* designated as an issue what is the "rate of return LECs' role in providing the services offered in their tariffs."[321] As that Order noted, some LECs do not own service origination points and are therefore unable to suspend the processing of an 800 service call in order to initiate a query to a neighboring regional data base for a call that originates in their service area. Those carriers may choose instead to route 800 calls to a neighboring LEC equipped with the requisite service origination point facilities that can initiate a query to a regional data base. In some of these cases, the originating LEC nonetheless has a charge in its tariff for providing this service. The Commission was concerned that so long as both the originating LEC and the neighboring LEC both had charges on file for basic query service, IXCs might be billed by both LECs for the same query. Therefore, the Commission invited parties to address whether the originating LEC may properly establish tariff charges for the query service when the neighboring LEC that provides the service also has charges for the service in its tariff.

[321] *Designation Order*, 8 FCC Rcd at 5136.

b. LEC Pleadings

197. LECs regulated pursuant to rate-of-return principles argue that the IXC will not be billed by two LECs for the same 800 data base query because meet point billing principles would apply to such arrangements between carriers.[322]

c. Oppositions

198. MCI is concerned that, when an originating LEC without a service origination point routes its 800 service calls to another LEC's service origination point, both LECs may bill for the query. MCI complains that most LECs have not explained how they would prevent double-billing for these query charges. MCI states that those LECs that did comment said only that meet point billing procedures would alleviate any such concerns, but do not explain how these procedures would prevent double-billing.[323]

d. Discussion

199. The Ordering and Billing Forum (OBF) of the Exchange Carrier Standards Association is a committee composed of LECs, IXCs and industry groups established to address billing issues that arise from the provision of access service by multiple LECs. The OBF has adopted a resolution that would resolve which carrier -- the originating LEC or the neighboring LEC -- may charge an IXC for a query when the originating LEC routes an 800 service call to a neighboring LEC for processing.[324] Given the composition and functions of the OBF, we believe it is preferable if this entity resolves any problems of double-charging of IXCs for the processing of a single query. Therefore, we will not impose any further requirements on the LECs in this proceeding.

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[322] Meet point billing is a method for the joint provision of access service through multiple-company ordering and billing arrangements. The arrangements deal with ordering criteria for each telephone company that provides joint access service with one or more telephone companies, and enable each telephone company to provide service and bill for its portion of access service furnished under its own tariff. *See* Waiver of Access Billing Requirements and Investigation of Permanent Modifications, CC Docket No. 86-104, 2 FCC Rcd 4518 (1987).

[323] MCI Opposition at 48.

[324] Letter from Susan Miller, Vice President and General Counsel, Alliance for Telecommunications Industry Solutions (ATIS), to William Caton, Acting Secretary, FCC (May 15, 1995).

2. Pass-Through of Regional Data Base Operator Rate Reductions

a. Statement of the Issue

200. The *Designation Order* designated the issue of whether the rate-of-return carriers' 800 data base tariffs properly reflect changes in the query rates that neighboring LECs charge to the 800 access provider to complete the 800 access service. Many LECs that do not own regional data bases purchase query service from another LEC and then resell it to IXCs for 800 calls originating in that LEC's service territory. Since March 5, 1993, there have been several reductions in the basic query and vertical features rates that the regional data base operators charge to IXCs and LECs without regional data bases. The LECs that do not own regional data bases but initiate queries as part of their 800 call processing were therefore asked to address whether reductions in the tariffed rates of the regional data base operators require reductions in the tariffed rates of those LECs that do not operate regional data bases.

b. LEC Pleadings

201. Rochester[325] says that it either flows-through the tariffed basic query charges from the neighboring regional data base operator or permits that carrier to bill 800 data base access customers directly. GVNW says that all its carriers pass-through the costs of 800 data base query service purchased from other carriers. GVNW states that the Commission has determined that a review of rate-of-return carrier rates and, in general, adjustment to those rates is required only every two years.[326] Moreover, says GVNW, the Commission's rules contemplate that tariffed rates only recover estimates of costs, and are not precise reflections of actual costs.[327] GVNW states that departing from these rules in the case of 800 data base access service would impose extensive administrative burdens on small rate-of-return LECs.

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[325] Rochester and its subsidiaries are price cap carriers but do not own regional data bases. They must either purchase query service from LECs that are regional data base operators or simply allow the regional data base operator to bill IXCs directly for queries originating from Rochester's territory. We have examined the reasonableness of Rochester's costs and the terms and conditions in its tariffs as part of our investigation of the issues designated for price cap carriers but include them in the discussion of the rate-of-return carriers because of the similarity of the issues faced by Rochester and the rate-of-return LECs.

[326] GVNW Reply at 3.

[327] *Id.*, *citing* Section 69.3 of the Commission's Rules, 47 C.F.R. § 69.3.

c. Oppositions

202. MCI argues that rate-of-return LECs must commit to reduce their rates to flow-through any reductions in the per-query rates charged by the regional data base operator from which they purchase query service. MCI complains that several of the LECs have indicated that they only want to make tariff revisions reflecting underlying regional data base cost changes when the impact on their own query rates is material.[328]

d. Discussion

203. Under rate-of-return regulation, the rates a carrier charges its customers for a service must be based on the carrier's costs of providing that service, plus a reasonable rate of return. Once the rate for a service is set, if a carrier's costs increase, it is allowed to raise its rates to cover those increased costs. If, on the other hand, a carrier's costs decrease significantly, it is obligated to lower its rates to avoid exceeding its rate of return. We anticipate that the significant disallowances of exogenous costs made by this Order will result in reduced basic query rates charged by regional data base operators. These reduced regional data base rates will, in turn, result in reduced charges for rate-of-return LECs that purchase query service from these regional data base operators, thereby reducing these carriers' costs.

204. We therefore require that the rate-of-return LECs that purchase query service from regional data base operators file, in accordance with paragraph 321 of this Order, tariff revisions reflecting the flow-through of any basic query rate reductions to their own customers -- IXCs that purchase query service from them. In the future, for any tariffed 800 data base access service they provide, the rate-of-return LECs and Rochester must also flow-through to their customers any further significant reductions in the basic query charges they pay to regional data base operators. To do otherwise could cause these rate of return LECs to exceed their allowed rates of return.

3. Adjustment for Unbillable Queries

a. Statement of the Issue

205. The *Designation Order* designated the subissue of whether the rate-of-return LECs properly estimated the demand on which their basic query rates are based. Several LECs that do not own regional data bases have adjusted their demand, when calculating their rates, to exclude an estimated number of unbillable queries. The unbillable queries occur, for example, when the regional data base operator does not provide a valid carrier

[328] MCI Opposition at 47-48.

identification code.[329] These LECs estimate that they will be unable to collect for up to 20 percent of the queries that originate from their service areas. To the extent that the tariffs of price cap carriers are discussed in this section, we will examine the reasonableness of their 800 data base rates.[330]

b. LEC Pleadings

206. The adjusted demand figures will have the net effect of recovering the costs for unbillable queries in the rates charged for completed queries. While some rate-of-return LECs made no adjustment to their rates to compensate for unbillable queries,[331] others did. Some LECs, in fact, assumed that up to 20 percent of queries[332] would be unbillable and adjusted their rates accordingly.[333] For instance, NECA states that the estimated percentage of unbillable queries for its members ranges from 0 percent to 5 percent based on varying operating conditions. The "composite percentage" of unbillable queries for its members was 1.9 percent.[334]

207. GVNW estimates that 15 percent of all queries would be unbillable to the IXC customer.[335] GVNW states that 800 data base is a new service and it was not possible to track percentages or volumes of unbillable calls before GVNW developed its rates.[336]

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[329] This issue is different from the issue of whether LECs should be able to bill for incomplete queries. In that instance, the IXC is identified but the call is not completed.

[330] *Designation Order*, 8 FCC Rcd at 5134.

[331] Great Plains Direct Case at 2; Cincinnati Direct Case at 5; GVNW Direct Case at 4; Lafourche Direct Case at 2.

[332] One Rochester subsidiary, Enterprise Telephone, charges end users a rate that is adjusted for unbillable queries.

[333] Sugarland Direct Case at 4 (4 percent adjustment); ALLTEL Direct Case at 4 (5 percent); NECA Direct Case at 9-10 (average of 1.9 percent); Roseville Direct Case at 3 (5 percent); TUECA Direct Case at 4 (10 percent); Rochester Direct Case at 5(20 percent).

[334] NECA Rebuttal at 3-4, *citing* NECA Direct Case at 8-10.

[335] GVNW Reply at 4.

[336] *Id.*

GVNW states that it will adjust its reserve for unbillable queries.[337] Finally, Roseville states that it lowered its demand estimate by 5 percent to compensate for unbillable queries.[338]

c. Oppositions

208. MCI criticizes the rate-of-return LECs' adjustments for unbillable queries, arguing that these LECs failed to justify the broad range of percentages used. It asks the Commission to restrict the LECs' queries to a maximum adjustment factor of 2 percent.[339]

d. Discussion

209. We recognize that unbillable queries constitute a genuine cost to the rate-of-return LECs that they should be allowed to recover in their rates. Some of the percentage factors used by these carriers, however, appear high when compared to those used by other LECs. For instance, Rochester's subsidiary, Enterprise, uses an unbillable query rate of 20 percent, while GVNW cites a rate of 15 percent and TUECA a rate of 10 percent. On the other hand, NECA, which has approximately 1,177 carriers in its traffic sensitive pool, shows a maximum unbillable query rate for its members of only 5 percent, with the average rate being only 1.9 percent.

210. The unbillable query rates estimated by some rate-of-return LECs are unsupported by the cost data they provide. The Commission therefore concludes that these estimates are unreasonable and may not be used to adjust the carriers' rates for unbillable queries. We find that a more reasonable and better supported unbillable query rate for carriers to use in their rate calculations is 5 percent -- the maximum estimated rate for NECA members. Therefore, all rate-of-return LECs must limit their unbillable query rate adjustment factor to no more than 5 percent. Any LEC that wishes to apply a higher adjustment factor must justify that factor in a separate tariff filing or in its next rate-of-return represcription proceeding.[340]

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[337] *Id.*

[338] Roseville Direct Case at 3.

[339] MCI Opposition at 47 (noting that Centel has reduced its estimate from 20 percent down to 2 percent, based on experience).

[340] The *Designation Order* specified, as issue 6, the "reasonableness of CCSCIS cost allocations." *Designation Order,* 8 FCC Rcd at 5137. Because none of the cost support materials ultimately used by the rate-of-return LECs were based on the CCSCIS model, this issue is moot and warrants no further investigation.

D. 800 SERVICE MANAGEMENT SYSTEM TARIFF

1. Background

a. Description of the Issue

211. The *Designation Order* designated the issue of whether the terms and conditions in the BOC central data base tariff are reasonable. Some petitioning parties complained about provisions setting forth the procedures for requesting and confirming IXC change requests, the liability provisions relating to patent infringement and the requirement that a Resporg purchase liability insurance. Petitioners also question the appropriateness of incorporating other documents, such as industry guidelines, by reference in the tariff. Finally, they challenge the reasonableness of the tariff requirement that requests for Resporg changes must be in writing and mailed to the Number Administration and Service Center (NASC), and that the NASC's confirmation notices also be sent by mail. The NASC provides customer service to Resporgs for the central data base and can change the designated Resporg for a particular 800 number upon request of the new Resporg.

b. Background

212. As described in paragraph 10, the 800 numbers are activated or the customer records or routing instructions are modified through the central data base. Bellcore, which developed the central data base, is a research and development organization jointly owned by the BOCs. Bellcore has formed a subsidiary, DSMI, that manages the operation of the central data base.[341] Most of the actual operating functions, such as operating the data base computers and responding to customer inquiries, are performed by subcontractors. Southwestern, as one of the subcontractors, operates the data center that operates the central data base computer. Lockheed IMS Company, another subcontractor, operates the customer service center that responds to customer inquiries from Resporgs and assigns 800 numbers. Bellcore, under contract, provides maintenance and updates the software for the central data base itself and for the software that compiles billing records for central data base transactions.[342]

213. The central data base performs two primary types of services. First, Resporgs can access the central data base to assign new 800 numbers or modify existing customer records. This service is provided pursuant to the tariff that was jointly filed by the BOCs and is subject to this investigation. Second, LECs that own regional data bases purchase

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[341] Direct Case of Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific, Nevada, Southwestern and US West (BOC Direct Case) at 29.

[342] *Id.* at 28.

services from the central data base that allow them to connect their regional data bases to the central data base and receive periodic updates of the 800 data base routing information stored in the centralized data base. These services are provided pursuant to contracts between the BOCs and each regional data base operator.[343] These contractual arrangements are not subject to this investigation.

2. Liability Provisions

a. LEC Pleadings

214. Under the central data base tariff, the BOCs indemnify Resporgs against patent infringement claims if the Resporgs take the service "as is" and do not modify it.[344] However, if the Resporgs or 800 subscribers combine the service they receive from the central data base with other facilities or equipment in such a manner as to infringe a patent held by a third party, the central data base tariff requires the Resporg to indemnify the BOCs against any liability they may have as providers of the central data base service. The BOCs state that they are entitled to be indemnified for any damages or harm caused by a Resporg's infringement of a patent held by a third party. The BOCs argue that this provision is fair because they are selling the central data base service "as is" and are not assuming any responsibility if the user of the service chooses to combine it with any other methods or processes. The BOCs also argue that the tariff properly protects them against possible patent infringement claims arising from the actions of others, such as Resporgs or 800 subscribers.

215. The central data base tariff also requires Resporgs to protect the BOCs, as owners of the central data base, against liability for personal injury and property damage. The BOCs argue that it is reasonable and consistent with normal commercial practices for the tariff to require Resporgs to carry insurance to protect the BOCs.[345] The BOCs also argue that it is reasonable to require the Resporgs to obtain a total of $2 million in liability insurance policies, to name the BOCs as additional insureds and to provide proof of insurance to them.[346] In justifying these requirements, the BOCs cite the risk of personal injury or property damage suits brought against the Resporgs by a third party. The BOCs are also concerned that a Resporg may cause damage to a third party if the Resporg makes a mistake in making a customer record change in the central data base.[347]

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[343] *Id.* at 26.

[344] BOC Reply at 6.

[345] *Id.* at 7.

[346] BOC Direct Case at 6.

[347] *Id.*

b. <u>Oppositions</u>

216. Allnet asserts that the central data base tariff section on patent liability is unfairly broad, negates another central data base tariff provision on indemnification and should be replaced with more standard patent infringement language found in other BOC tariffs.[348] Further, Allnet argues that liability insurance should not be required as proposed in the central data base tariff. Allnet argues that, unlike physical interconnection, there is no danger of actual damage to the central data base and no need for liability insurance.[349]

c. <u>Discussion</u>

217. We do not find the patent infringement provisions of the central data base tariff to be unreasonable. They merely protect the BOCs from liability where a third party infringes a patent they are responsible for protecting. Therefore these provisions do not deviate from standard tariff practices and we will not require the BOCs to change them.

218. We find that the liability insurance requirements, on the other hand, are unreasonable. We see no reason why the BOCs should require Resporgs to carry insurance that could be used to compensate the BOCs for claims lodged against them by third parties. The central data base tariff could legitimately require Resporgs to indemnify the BOCs for claims resulting from the negligent or willful misconduct of the Resporg. The insurance requirements, however, are extraordinary in tariff practice and would place an unreasonable burden on entities wishing to become Resporgs in violation of Section 201(b) of the Communications Act.[350] Therefore, we find that these insurance requirements are unreasonable and we will require the BOCs to eliminate them. If the BOCs are concerned about the damage that may result from actions by unscrupulous Resporgs, they can establish reasonable qualifications pursuant to the *Comptel Petition Order*.[351]

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[348] Allnet Opposition at 8-10.

[349] *Id.* at 10-11.

[350] 47 U.S.C. § 201(b).

[351] *Comptel Petition Order*, 8 FCC Rcd at 1428.

3. Incorporation by Reference of the Industry Guidelines for 800 Number Administration

a. Background

219. The Ad Hoc 800 Data Base Committee of the Carrier Liaison Committee has developed voluntary industry guidelines to govern the administration of 800 numbers.[352] The committee is made up of LECs, IXCs, 800 service subscribers and various industry organizations. The introduction to the guidelines[353] says that "while compliance is voluntary, deliberate abuse of these guidelines may be referred by any participant to the Federal Communications Commission of the United States Government."[354]

b. LEC Pleadings

220. The BOCs oppose incorporating provisions that are now in the guidelines into the tariff. The BOCs state that the central data base tariff only includes those items from the guidelines that are "truly defined as [central data base] system requirements."[355] The BOCs also argue that the guidelines are subject to ongoing modification by the industry and the fact that many guidelines are incorporated by reference, rather than included as specific terms in the central data base tariff gives the BOCs the flexibility necessary to respond to industry needs because the guidelines can be amended by the industry without having to amend the tariff.[356]

c. Oppositions

221. MCI argues that referencing the guidelines in the central data base tariff is not adequate to ensure that Resporgs will operate in a way that does not affect the quality of service that other Resporgs can provide to their customers. MCI claims that the central data

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[352] The BOCs state that the Ad Hoc 800 Committee of the Carrier Liaison Committee "is comprised of industry experts in 800 service from local exchange carriers, interexchange carriers, subscribers and various industry organizations." BOC Direct Case at 9.

[353] Industry Guidelines for 800 Number Administration, Issue 3.0, December 1, 1993.

[354] *Id.* at iii.

[355] For example, the central data base tariff contains provisions limiting such things as the number of days an 800 number can remain on reserved status and the quantity of 800 numbers that any given Resporg can hold on reserve. *See* BOC Direct Case at 9.

[356] *Id.* at 9-10.